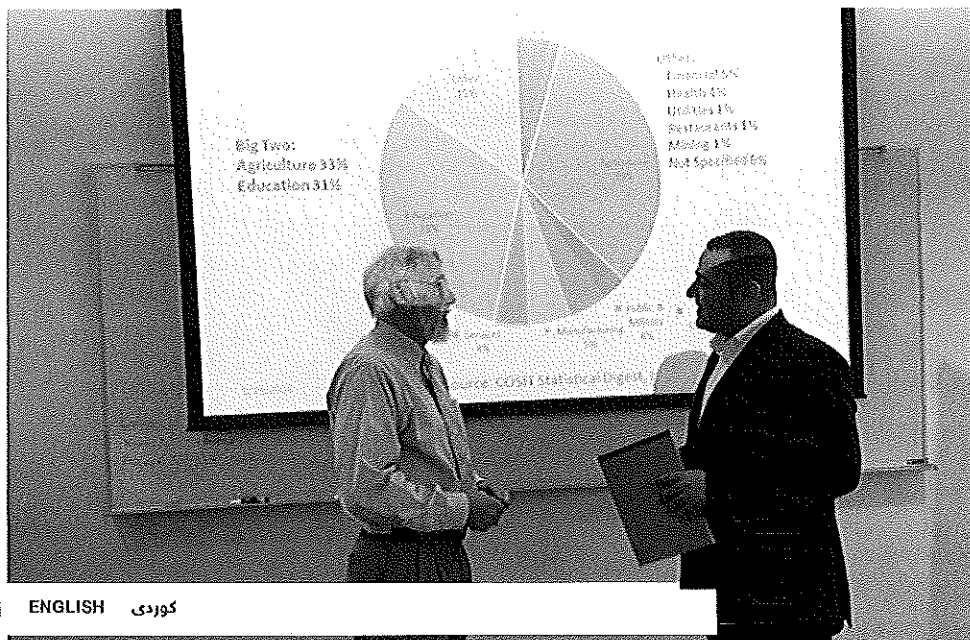


Iraq's Perfect Storm: The Challenges of ISIS and Oil

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Professor Frank R. Gunter (left) and Harem Karem

[Professor Frank R. Gunter:](#)

Professor Frank R. Gunter (author of 'The Political Economy of Iraq') spoke to Harem Karem about Iraqi and KRG corruption, ISIS, the oil price drop, partition and other issues.

HK: You have called for fundamental change in the Iraqi economy; aside from the huge challenges posed by the rise of ISIS and the oil price falls, have there been any improvements in economic and related policies under Abadi?

FG: I don't think so, I think it is too early. One favourable moment is that there is a recognition of the scale of the problem. Former Prime Minister Maliki largely ignored the existence of the problems caused by over-dependence on oil; by contrast, the incumbent Prime Minister, Abadi, has said to the Shia and Sunni communities that he does recognise the problems the country faces. If you ask me what is the biggest challenge in addition to what you just mentioned, it is the unemployment issue. Iraq is an extremely young country, it has a very high fertility rate - the average woman has 4.1 children - which means that every year about 800,000 Iraqis become old enough to join the labour force. Now, subtract the people who are retired, and take into account that the labour force participation among women is very low, and it still comes to an annual growth of a third of a million of new job seekers. Iraq must create a third of a million new jobs every year. If they fail to do this, then the pool of unemployed -- mostly uneducated, unskilled young men -- becomes larger and that is politically destabilising.

HK: Is such growth feasible given the state of Iraq's private sector?

FG: This problem didn't start in 2003; it started with Saddam Hussein's

administration. The Government of Iraq has been the employer of first resort reflected in federal budget policy, which called for the creation of about a quarter of a million government jobs every year just to absorb these young people. The Government of Iraq can no longer afford to create more government jobs due to the 2014 collapse in oil prices. There has been much talk since Saddam was overthrown about building the private sector. The time for talking is over. What is necessary now is political courage, not only from the Prime Minister, but also from the Council of Representatives to do it.

HK: How do you define the ISIS economy?

FG: It is an organised theft. When you look at their sources of funding in 2014 and 2015, their biggest source of income was robbing branches of Rafidain and Rasheed banks. It is estimated that they stole about \$500 million. But that is something you can do only once; you cannot go back and rob the same banks again. Another source of stolen funds is looting farmers in Anbar, where 40% of the provincial income is from farming. ISIS stole crops from silos, they taxed farmers, they diverted water and seed to those with whom they had connections or paid bribes and, as a result, agricultural production dropped sharply in Anbar. The same is true of the other agricultural provinces ISIS has occupied. Again, the impoverishment of farmers sharply reduces the amount that ISIS can steal in the future.

HK: Don't you think there is international financial assistance?

FG: I don't think so. I think ISIS is unlike Al Qaeda; its source of revenue is mainly domestic as opposed to it receiving international donations. My perception is that, since this is theft, when they take over a city like Mosul or Ramadi, they loot it straight away.

HK: What about their oil export?

FG: Most of the oil in Iraq originates near Basrah and is exported through the Persian Gulf or is in areas controlled by the Kurdistan Regional Government and is exported through the new pipeline into Turkey. There is very little oil and gas produced in the areas of Iraq controlled by ISIS. But in the areas they control in Syria, they have petroleum.

HK: How can ISIS be defeated?

FG: I think ISIS is in a situation where it has to either grow or die; if it cannot conquer new cities to loot, their finances will dry up. Information coming out of the ISIS-controlled area indicates that, not only have essential services been cut back, but also ISIS soldiers are getting paid less. So I think ISIS is beginning to face a financial crisis. It does little damage to ISIS finances for the Government of Iraq to reconquer a devastated city that ISIS currently controls; what must be done is to prevent ISIS conquest of new territory that can be looted; its attempts to smash and grab - to attack and loot - must be thwarted. If we can cut their finance, then it will become much weaker.

HK: Shall we talk about the politics of it too?

FG: The Sunni were betrayed by former Iraqi Prime Minister Maliki. During the 'Awakening', the sons of Anbar province were promised that they would get government jobs; they would be recruited by either the ministry of interior police or the ministry of defence. That promise was broken. In 2010, the al-Iraqiyya Party -- which was headed up by a Shia but had strong Sunni support -- won the biggest number of seats in the Council of Representatives, but after ten months of negotiation they ended up with nothing. The Sunnis learnt that the promises made by Baghdad were broken. The final big mistake was that Maliki and President Obama agreed on pulling out the American troops by the end of 2011. There are certain advantages that the Americans can provide to the Iraqi forces; they are very good at intelligence fusion, providing secure communications, and coordinating air support, but the fight on the ground has to be done by Iraqis. There are now a reported 3600 Americans back in Iraq. I think that PM Abadi has

to be able to make credible commitments of reconstruction aid and employment to the communities of the four provinces that have lost significant territories to ISIS and, when ISIS is defeated, these promises have to be kept. However, it will be hard to make credible commitments when government revenues are ravaged by low oil prices.

HK: Why isn't the US supplying necessary equipment to the Peshmerga?

FG: One of the arguments put forward is that the US government has insisted on working through Baghdad and the supplies aren't getting to the Peshmerga units on the ground. To comment on this requires information I don't have.

HK: What is your view of the Baghdad-Erbil revenue dispute? How should it be resolved?

FG: I had a conversation with a former Iraqi Ambassador to the US in 2010. I asked: 'Why hasn't the full 17% of the national budget been allocated to the KRG?' His response was: "Baghdad shouldn't give the KRG 17%". He added: "Baghdad should give the KRG 21%". He went on to say: "Baghdad should make the KRG feel part of the community; if they need support, they should get more than they ask for." I think he was right at the time, and maybe this would have changed attitudes on both sides. When the two families of the KRG demanded 17%, Baghdad should have given them 21%. Everything becomes more complex now because of the oil price drop. The Iraqi finance minister has said that their expectation of oil revenue in 2016 is that it will be insufficient to cover salaries and pensions -- and there goes all the funding they were planning for new investment in sectors outside of oil, the 17% share for the KRG and the 5% war reparations for Kuwait.

HK: Which do you think is more corrupt: the central government or the KRG?

FG: I will try and avoid that question because the level of corruption is difficult for an outsider to judge. But the question that comes up a lot is: Are the current Iraqi government and the KRG more corrupt than the government of Saddam Hussein? I would argue that Saddam stole more and did less damage, because it was structured, it was organized. There is a joke about an honest judge in Chicago. "What is an honest judge in Chicago? An honest judge in Chicago is one who, when you pay him a bribe to do something, he does what you paid him to do." Under Saddam, it was structured; his family and his supporters had to gain from every transaction, but once you made sure they gained, it was predictable. Now corruption is at every government level; they are competing against each other. It's not the amount they are stealing, it's the uncertainty. Who do I bribe, how much, and what do I gain in return? One of the most effective measures that exists in the world to fight corruption is vigorous journalism, but it is dangerous in many parts of the KRG and Iraq to be an aggressive journalist. What we need is investigative reporting -- exposing the government officials.

HK: What key measures should the KRG take to escape from its current crises and economic vulnerabilities (huge debts, unpaid salaries, import dependency, etc.)?

FG: The oil export is either going through Somo or to Turkey and neither is going to be sufficient. My prediction is that we are looking at about ten years of low oil prices, less than \$60 a barrel. So what can be done? Three provinces of the KRG have the highest level of government employment of any provinces in Iraq. Creation of jobs in the private sector is required but that faces two challenges:

- First, the regulatory hostility: The government makes it almost impossible to do business. Registration, licensing and other essentials to run a legal business are expensive and difficult, especially if you are not a lawyer.

- Second, the corruption: Everybody's talking about corruption but not much is being done about it. There are a few cases of successful anti corruption drives, such as in Hong Kong; it was one of the most corrupt cities on earth in the 1950s

and became one of the most honest cities in the 1970s. If you look at its success in tackling corruption it is about attacking the economic incentives. Arresting corrupt officials and putting them in jail doesn't reduce corruption if the replacement officials face the same incentives. In New York City, there is an expression that, if you throw out the rotten apples but keep using the same apple barrel, then you will have to do it again next year. And that is what's happening. Hence we need to change the incentives, possibly by delegating business regulations to the eighteen provinces -- except for the regulation of the financial system -- as opposed to having all business regulation controlled by Baghdad. This would lead to regulatory competition and reduced corruption.

HK: Why isn't the US government taking necessary measures to prevent Iraqi officials depositing large chunks of money in the international banks?

FG: I understand that the US Treasury takes it seriously; the issue is that according to US law there is a deliberate process required. While this process is being followed, corrupt Iraqi individuals can always transfer their money somewhere where there's no questions asked. The capital flight from Iraq since 2003 is estimated to have been six to eight billion dollars a year. Over a decade, that means 80 to 100 billion dollars left the country illegally and was hidden away in various parts of the world. Getting that back is going to be a long, hard process.

HK: Former KRG Prime Minister Dr Salih has called for the repatriation of the stolen money. What would be the process of enforcing this?

FG: Much of this money is hidden in the non-cooperating countries. The Swiss, German, US and Hong Kong banks to an extent will cooperate. But the Iraqi government will have to provide documentation proving misconduct.

HK: What if the government itself is the prime suspect?

FG: Now you have a serious issue there. If the ministry of finance provide documents on officials, then the US, Switzerland, Germany and Hong Kong will cooperate, but it is a long and hard process. So, even with US Treasury cooperation, it will take years to complete the process.

HK: Do you favour Iraqi unity or partition?

FG: Unity, of course. There are big demographic issues; partition would cause ethnic cleansing on the scale of when India and Pakistan broke up. The biggest loser of the break up would be Anbar province, without significant oil or easy access to the rest of the world. So far, as part of Iraq, the KRG has been able to play off Turkey and Baghdad, often very successfully, but the possibility of oil exports and trade between an independent KRG and South Iraq would be limited. The KRG would be left at the mercy of Turkey, and Iran to some extent. While the US government is currently leaning towards supporting the KRG, I doubt if they would support an independent Kurdistan.

HK: If we could turn back the clock to 2002, what would you have the US administration do differently in Iraq?

FG: I think the invasion of Iraq was the right thing to do. As bad as the democracy is in Iraq, it is still better than the dictatorship. I think the big mistake we made was after the defeat of Saddam, when the Americans thought the war was over, it wasn't. It had only just started. In retrospect, I would have said: Let's bring in half a million soldiers of the coalition armies and occupy all the towns and cities, stop the looting of public places such as the museum artifacts and restore order. The second thing I would have done is an alternative to having a constitution signed in 2005, followed by a national election. I think we should have started in 2003 with elections from the bottom up, from the villages, then a year later elections at the provincial level, and then maybe a year later an election at the national level. Democracy is hard, especially for people with limited experience. Another mistake that bordered on stupidity was when the representatives were divided into sectarian representations: Shia, Sunni, Kurds, Turkomans, etc. I think a regional approach to representation in Iraqi politics would have worked much better.

HK: Would you still have dismantled the Iraqi army?

FG: Absolutely. The Iraqi army was incompetent, corrupt and unfit for its purpose. But we could have rebuilt the Iraqi army in a much more efficient way. It takes three years minimum to train an army officer, but we didn't do that. We could have combined three years of training to become a professional army officer with, for example, civil engineering. That way, every graduate would have a job opportunity other than the army. Instead we said, let's rebuild the Iraqi army quickly; we only allocated six weeks of training and that was insufficient.

HK: Thank you very much.

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